

## Internal Revenue Service

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Person To Contact:  
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Date:  
March 25, 2016

Re:

### Legend

Husband	=
Wife	=
Trust	=
Trust 1	=
Trust 2	=
Trust 3	=
Date	=
Year	=
<u>x</u>	=
<u>y</u>	=
Accountant	=
Year	=

Dear :

This letter responds to your letter dated October 5, 2015, requesting rulings that, for purposes of § 2642(g)(2) of the Internal Revenue Code, taxpayers substantially complied with the requirements to elect out of the automatic GST allocation rules under § 2632(c) and to affirmatively allocate their GST exemption to transfers to certain trusts.

The facts and representations are as follows:

On Date, Husband and Wife established Trust, an irrevocable trust. Trust provides that, upon creation, Trust would be divided into three separate trusts, Trust 1,

Trust 2, and Trust 3, each trust benefiting one of their children and that child's descendants. Trust also provides that the trustee may further divide Trust 1, Trust 2, and Trust 3 into two or more trusts to allocate different inclusion ratios for GST purposes.

Pursuant to Trust, each of Trust 1, Trust 2, and Trust 3 was divided into two subtrusts, an Exempt Trust and a Non-Exempt Trust, resulting in six trusts: Trust 1 Exempt Trust, Trust 1 Non-Exempt Trust, Trust 2 Exempt Trust, Trust 2 Non-Exempt Trust, Trust 3 Exempt Trust, and Trust 3 Non-Exempt Trust.

In Year, Husband and Wife each transferred \$x to each of the exempt trusts and \$y to each of the non-exempt trusts. Specifically, Husband gifted \$x to Trust 1 Exempt Trust, \$x to Trust 2 Exempt Trust, and \$x to Trust 3 Exempt Trust. Husband also gifted \$y to Trust 1 Non-Exempt Trust, \$y to Trust 2 Non-Exempt Trust, and \$y to Trust 3 Non-Exempt Trust. Wife did the same.

Husband and Wife retained Accountant to prepare his and her respective Year Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Return. Husband and Wife elected to split the gifts to the trusts pursuant to § 2513. Accountant, in preparing the Forms 709, properly reported the gifts to each of the exempt trusts and the non-exempt trusts on Part 3 of Schedule A, but failed to check Column C on Part 3 of Schedule A (§ 2632(c) election) to indicate that Husband and Wife elected out of the automatic allocation rules. Accountant prepared an election out statement to be attached to each return, but in preparing the Notice of Allocation, Accountant inadequately described the trusts to which GST exemption was to be allocated. Accountant timely filed the Forms 706 and attached a copy of Trust to each return.

Husband and Wife request rulings that, for purposes of § 2642(g)(2), they substantially complied with (1) the requirements under § 2632(c) and § 26.2632-1(b)(2)(iii)(B) of the Generation-Skipping Transfer Tax Regulations for electing out of the automatic allocation rules; and (2) the requirements under § 26.2632-1(b)(4) for allocating their GST exemption to the transfers to Trust 1 Exempt Trust, Trust 2 Exempt Trust, and Trust 3 Exempt Trust.

### Law and Analysis

Section 2601 imposes a tax on every generation-skipping transfer (GST). A generation-skipping transfer is defined under § 2611(a) as a taxable distribution, a taxable termination, and a direct skip.

Section 2602 provides that the amount of the tax is the taxable amount multiplied by the "applicable rate." Section 2641(a) defines the applicable rate as the product of the maximum Federal estate tax rate and the inclusion ratio with respect to the transfer.

Under § 2642(a)(1), in part, the inclusion ratio with respect to any property transferred in a generation-skipping transfer is the excess (if any) of 1 over the applicable fraction determined for the trust from which such transfer is made. Section 2642(a)(2) provides, in part, that the applicable fraction is a fraction (A) the numerator of which is the amount of the GST exemption allocated to the trust, and (B) the denominator of which is (i) the value of the property transferred to the trust, reduced by (ii) the sum of (I) any Federal estate tax or State death tax actually recovered from the trust attributable to such property and (II) any charitable deduction allowed under § 2055 or 2522 with respect to such property.

Section 2631(a) provides that, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, is irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for the individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed. Under § 26.2632-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations, an allocation of GST exemption to property transferred during the transferor's lifetime is made on Form 709. The allocation must clearly identify the trust to which the allocation is being made and the amount of GST exemption allocated to it. The allocation should also state the inclusion ratio of the trust after the allocation.

Section 2632(c)(1) provides that if an individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. Under § 2632(c)(3)(A), the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust, as defined in § 2632(c)(3)(B). Under § 2632(c)(3)(B), a GST trust is a trust that could have GST transfer with respect to the transferor unless the trust satisfies any of the exceptions listed in § 2632(c)(3)(B)(i)-(vi).

Section 2632(c)(5)(A)(i) provides that an individual may elect to have the automatic allocation rules of § 2632(c)(1) not apply to an indirect skip, or any or all transfers made by such individual to a particular trust. Section 2632(c)(5)(B)(i) provides, in part, that the election shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made.

Section 26.2632-1(b)(2)(i) provides that in the case of an indirect skip made after December 31, 2000, to which § 2642(f) (relating to transfers subject to the estate tax inclusion period or ETIP) does not apply, the transferor's unused GST exemption is

automatically allocated to the property transferred (but not in excess of the fair market value of the property on the date of the transfer). This automatic allocation is irrevocable after the due date of the Form 709 for the calendar year in which the transfer is made.

Section 26.2632-1(b)(2)(ii) provides that, except as otherwise provided, the transferor may prevent the automatic allocation of GST exemption with regard to an indirect skip by making an election as provided in § 26.2632-1(b)(2)(iii). The transferor may also prevent the automatic allocation of a GST exemption with regard to an indirect skip by making an affirmative allocation of GST exemption on a Form 709 filed at any time on or before the due date for timely filing of an amount that is less than (but not equal to) the value of the property transferred as reported on that return.

Section 26.2632-1(b)(2)(iii)(A) provides that a transferor may prevent the automatic allocation of GST exemption (elect out) with respect to any transfer or transfers constituting an indirect skip made to a trust or to one or more separate shares that are treated as separate trusts under § 26.2654-1(a)(1). In the case of a transfer treated under § 2513 as made one-half by the transferor and one-half by the transferor's spouse, each spouse shall be treated as a separate transferor who must satisfy separately the requirements of § 26.2632-1(b)(2)(iii)(B) to elect out with respect to the transfer. Under § 26.2632-1(b)(2)(iii)(B), to elect out, the transferor must attach a statement (election out statement) to a Form 709 that identifies the trust and specifically provides that the transferor is electing out of the automatic allocation of GST exemption with respect to the described transfer or transfers. Section 26.2632-1(b)(2)(iii)(D) provides that an election out does not affect the automatic allocation of GST exemption to any transfer not covered by the election out statement.

Section 2642(g)(2) provides that an allocation of GST exemption under § 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer to a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument.

Section 2513(a)(1) provides that a gift made by one spouse to any person other than his or her spouse shall be considered as made one-half by the donor spouse and one-half by his or her spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. Section 2513(a)(1) shall apply only if both spouses have signified their consent to the application of paragraph (1) in the case of all such gifts made during the calendar year by either while married to the other.

Section 2652(a)(1)(B) provides that in the case of any property subject to the tax imposed by chapter 12, the donor is the transferor for purposes of chapter 13. Section 2652(a)(2) and § 26.2652-1(a)(4) provide that, if, under § 2513, one-half of a gift is

treated as made by an individual and one-half is treated as made by the spouse of the individual, then each spouse is treated as the transferor of one-half of the entire value of the property transferred by the donor spouse, regardless of the interest the electing spouse is actually deemed to have transferred under § 2513.

In the present case, the information on the Year Forms 706, including the Notice of Allocation and election out statement attached to each return, in combination with the terms of Trust (a copy of which was attached to each return), provides sufficient information to constitute substantial compliance under § 2642(g)(2).

Accordingly, based upon the facts submitted and the representations made, we conclude that, for purposes of § 2642(g)(2), Husband and Wife substantially complied with the requirements to elect out of the automatic GST allocation rules under § 2632(c) with respect to the transfers to Trust 1, Trust 2, and Trust 3. In addition, Husband and Wife substantially complied with the requirements to timely allocate their GST exemption to Trust 1 Exempt Trust, Trust 2 Exempt Trust, and Trust 3 Exempt Trust.

The rulings in this letter pertaining to the federal estate tax apply only to the extent that the relevant sections of the Code are in effect during the period at issue.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code. This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Leslie H. Finlow

Leslie H. Finlow  
Senior Technician Reviewer, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

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